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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 863

MAGNUS, MABEE & REYNARD, INC., ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 311 F. 2d 12.

JURISDICTION

The judgment of the court of appeals was entered on December 6, 1962. (Pet. App. 1a.) The petition for a writ of certiorari was filed February 25, 1963. The jurisdiction of this Court is invoked under 28 U.S.C., 1254(1).

QUESTION PRESENTED

Whether the taxpayer may enjoin enforcement of an Internal Revenue Service summons directing a third party to produce records relating to his tax liabilities when compliance with the summons has been resisted for such a prolonged period that the United States, in the interim, has been forced to obtain an indictment against the taxpayer to prevent the running of the statute of limitations.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear

before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(26 U.S.C. 1958 ed., Sec. 7602.)

SEC. 7605. TIME AND PLACE OF EXAMINATION.

* * * *

(b) Restrictions on Examination of Taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

(26 U.S.C. 1958 ed., Sec. 7605(b).)

STATEMENT

Percy A. Magnus, petitioner and taxpayer, owns over 80% of the stock of Magnus, Maybee & Reynard, Inc., the petitioner corporation, and derives most of his income from it (R. 28a-29a).[1] He filed no personal income tax returns for the years 1948 through 1957 until, in 1959, the Internal Revenue Service began an investigation of his affairs. There-

[1] The designation "R." will be used to refer to the appendix to petitioners' brief in the court of appeals.

upon, he filed delinquent returns showing gross income in excess of $1,280,000 (R. 28a, 31a) and paid the taxes which the returns indicated were due (R. 16a; Pet. 4-5).

On June 19, 1961, a special agent of the Internal Revenue Service issued two summonses (R. 11a-12a, 20a-21a) under authority of Section 7602 of the Internal Revenue Code of 1954, *supra*, p. 2. Both summonses were entitled: "In the matter of the tax liability of Percy C & Margaret A. Magnus." One was directed to the petitioner corporation and required the production of certain corporate records for the period 1948 through 1957. (R. 11a.) The other was directed to Hurdman and Cranstoun, a firm of accountants, and required the production of all records, work papers and other documents, for the same period, "relating to transactions with, for or on behalf of Percy C. Magnus or Magnus, Mabee & Reynard, Inc." (R. 20a-21a). Continuing litigation as to the propriety of these summonses has thus far prevented the government from obtaining compliance with either of them.

In the first round of litigation, the taxpayers, Percy C. and Margaret A. Magnus, filed a motion in the district court to quash the summonses on the ground that they were in support of an "unnecessary" examination or investigation, within the meaning of Section 7605(b) of the Internal Revenue Code of 1954 (*supra*, p. 3). The Court of Appeals for the Second Circuit, on February 13, 1962, affirmed the order of the district court denying the motion

to quash. *Application of Magnus*, 299 F. 2d 335 (C.A. 2). This Court denied certiorari on June 11, 1962, 370 U.S. 918.

On April 10, 1962, before this Court denied certiorari, an indictment was returned charging Percy C. Magnus with income tax offenses relating to the years 1955, 1956, and 1957. (R. 16a; Pet. App. 3a.) Thereafter, on July 13, 1962, the United States Attorney notified the corporation and the accountants by letter that the petition for certiorari had been denied and that they were "now required to comply" with the summonses served on June 19, 1961, by appearing with the required records before the special agent on July 18, 1962. (R. 13a-14a, 22a-23a.)

On July 18, 1962, the corporation filed an "application" in the district court, in the form of an affidavit by its vice-president, praying that the summons directed to it be quashed. (R. 1a, 5a-10a.) On July 20, 1962, Percy C. Magnus filed a similar "application" to quash the summons directed to the firm of accountants. (R. 1a, 16a-19a.) The latter firm was not and is not a party to the proceedings to quash.

The principal basis of the corporation's "application" was that, subsequent to the service of the summons, Percy C. Magnus had been indicted for failure to file tax returns and wilful attempt to evade income tax (R. 7a, 32a), and that "use of the Internal Revenue Service summons under the circumstances is a violation of law and an abuse of administrative process to obtain compulsory pre-trial discovery * * * in a criminal case" (R. 5a). Percy

C. Magnus based his motion on the same ground. (R. 16a-18a, 35a-36a.)

On September 19, 1962, the district court denied both motions. (R. 32a-36a.) The United States Court of Appeals for the Second Circuit affirmed on December 6, 1962 (Pet. App. 1a-9a), and both the corporation and Magnus now petition for a writ of certiorari to review this judgment.

ARGUMENT

Petitioners argue that the court of appeals erred in permitting the federal prosecutor to circumvent the statutory limitations upon the government's right to pre-trial discovery, and in permitting the Internal Revenue Service to enforce an administrative summons for purposes outside the scope of Section 7602. There is no merit in these contentions. Section 7602 authorizes the issuance of a summons

> [f]or the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, * * *

Here summonses were issued by the special agent to the taxpayer's corporation and to the accountants (who had prepared his delinquent returns) for the purpose of determining whether the returns were correct (R. 29a-31a). Ten months later, the government was forced to return an indictment against the

taxpayer in order to prevent the running of the statute of limitations. But the responsibility of the examining agent is not exhausted, nor does a summons under Section 7602 become unenforcible, merely because an indictment has been returned. On the contrary, in order to establish the correct tax liability and whether the 50% civil fraud penalty should be imposed, the agent is required to report to his superiors all unreported income disclosed by his investigation regardless of whether a criminal case is developed (R. 30a). And here the special agent was unable to complete his report without the records sought by the summonses.[2]

To hold that a revenue agent is powerless to obtain information under Section 7602 merely because that information might ultimately be used in a criminal proceeding would, as the court below noted, "virtually write that Section out of the statute" (Pet. 7a). It is clear, moreover, that an Internal Revenue summons will be enforced by the courts so long as it has been issued, as here, for "the purpose of ascertaining the correctness of any return" (see 26 U.S.C. 7602, *supra*, p. 2), even though the Internal

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[2] Admittedly, the normal statute of limitations already bars assessment of civil tax deficiencies as to most of the years involved. But in case fraud is discovered, the assessment may, of course, be made at any time. Section 6501(c)(1) and (2), Internal Revenue Code of 1954, 26 U.S.C. 6501(c)(1) and (2). The return of the indictment makes it clear that the special agent already has *some* evidence of fraud, but he would hardly be fulfilling his function properly if he completed his report without examination of the books of the corporation, the source of petitioner Magnus' income.

Revenue Service may have other purposes in mind at the same time. *Boren* v. *Tucker*, 239 F. 2d 767, 772-773 (C.A. 9); *Lash* v. *Nighosian*, 273 F. 2d 185, 187-188 (C.A. 1), certiorari denied, 362 U.S. 904. If a summons, valid when issued, were to become unenforcible the moment an indictment is returned, delinquent taxpayers would have a strong incentive to do precisely what was attempted here —resist the enforcement of the summons until prosecution for criminal tax evasion is barred by the statute of limitations.

The two district court cases relied upon by petitioner, *United States* v. *O'Connor*, 118 F. Supp. 248 (D. Mass.), and *Application of Myers*, 202 F. Supp. 212 (E.D. Pa.), are inapposite. In *O'Connor*, the summons was issued after the return of the indictment and after the agent had already completed his investigation and turned his report over to higher authorities. And the agent admitted that the sole purpose of seeking information was to further the criminal prosecution already under way. In *Myers*, similarly, the summons was issued only a few days before the criminal prosecution was set for trial, and the court found that its sole purpose, openly avowed, was to obtain information in aid of the government's case on the indictment.

2. It is doubtful that a district court has jurisdiction to entertain an independent plenary action to enjoin the enforcement of an Internal Revenue summons. See *Reisman* v. *Caplin* (C.A. D.C.), C.C.H. ¶ 9255, decided February 7, 1963; but see *Applica-*

tion of Colton, 291 F. 2d 487 (C.A. 2).[3] Moreover, even if such an action could be brought by the party (here, the petitioner corporation) to whom the summons was addressed, and who might be exposed to criminal penalties if he failed to comply (under 26 U.S.C. 7604(b) or 26 U.S.C. 7210; see *Colton*, *supra*), it would not follow that any other person (*e.g.*, the taxpayer here) would have such standing. Since the taxpayer's motion was based solely upon the contention that the summons would accord the United States improper pre-trial discovery in its criminal action against the taxpayer, the motion should be treated as ancillary to the pending criminal proceeding. Viewed in that light, however, its denial is an interlocutory ruling and hence unappealable. *DiBella* v. *United States*, 369 U.S. 121. Furthermore, the petitioner corporation, even granting *arguendo* its right to bring a plenary action, nonetheless does not have standing to complain of the threatened injury to its stockholder, the taxpayer.

Finally, even if petitioners could institute a plenary civil action to quash the summonses, they clearly could not do so by means of the summary procedure invoked here.

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[3] During oral argument in *In re Turner*, 309 F. 2d 69, Judge Friendly, who wrote the Second Circuit's decision in *Colton*, specifically invited government counsel to reargue the *Colton* decision, and this invitation was repeated by Chief Judge Lumbard at a subsequent argument (*United States* v. *McDonald*, decided February 25, 1963, reported at 11 A.F.T.R. 2d 899). The government intends to present the issue again as soon as a suitable case reaches the Second Circuit.

3. A plenary civil action to quash the summonses could not properly be brought by means of the summary procedure instituted by petitioners here. In *New Hampshire Fire Ins. Co.* v. *Scanlon*, 362 U.S. 404, a case which began with the filing of a "petition" to quash certain notices of levy and the issuance of an order to show cause to the District Director of Internal Revenue, this Court held that since no proper complaint had been filed and no summons issued, the proceeding was without authorization under the Federal Rules of Civil Procedure. 362 U.S. 406-407. The present record manifests the same disregard for the provisions of the Federal Rules governing the institution of a plenary civil action. This case, too, was commenced by the filing of "applications" and the issuance of orders to show cause. (R. 3a-5a, 15a-16a.) The "applications" named no defendants (R. 3a, 15a) and contained no jurisdictional statement in its body, as a "complaint" is required to do under the Federal Rules.[4] And no summons was issued to the Attorney General, to the United States Attorney, or to anyone in the Internal Revenue Service,[5] although these officials of the United States were obviously the intended defendants. What petitioners apparently did was to invoke a summary procedure appropriate to ancillary motions in plenary actions.[6] And, as we have pointed out, if petitioner

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[4] Rules 1, 2, 3, 8(a)(1), 10(a).

[5] Rule 4(a), (c), (d)(4) and (5).

[6] Since there was no pending action, the district court clerk entered the "applications" on the Miscellaneous Docket. (R. 1a.)

Magnus should insist that his "application" was made as part of the criminal case pending against him, the ruling on it would be nonappealable. *DiBella* v. *United States*, *supra*.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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APRIL 1963.

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